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SEPARATION OF THE SOURCES OF STATE AND LOCAL REVENUES[1]

It is important to note, that separation of state and local revenues has ceased to be merely an end in itself, and has taken on added significance as the initial step of a thoroughgoing reform. "We are justified," says the recent Missouri Tax Commission, "in saying that this separation of the sources of state and local revenues is now generally recognized as the first essential step in any enduring tax reform."

The second step, in the opinion of most writers and tax commissioners who have recently considered this subject, is the so-called "home rule" or "local option." "Separation," says the report of the California Commission (of 1906) on Revenue and Taxation (page 11), "establishes, at once, home rule in matters of local taxation." And so, similarly, the report of the Missouri Commission of 1907 (page 10): "The local taxing districts, the counties and cities of the state, will then [when separation is effected] have practical home rule in matters relating to taxation." And, "as regards the question of adequate local revenue, the simplest plan indeed," as Professor Seligman expresses it, "is to have a separation of state and local taxation, with local option on the part of the localities to tax or to exempt from taxation whatever classes of property they see fit."[2]

[1] Read at the National Conference on State and Local Taxation, held at Columbus, Ohio, November 12–15, 1907, under the auspices of the National Tax Association.

[2] *Political Science Quarterly*, Vol. XXII, pp. 312, 313.

From these expressions it would appear that the dual programme of separation and home rule is one, primarily, of financial decentralization. The state government having taken over most of the fees and license taxes, nearly all of the corporation taxes, and perhaps some of the taxes on personal property, in addition, of course, to the inheritance tax, blandly says to the wondering little local governments gathered about the maternal knee: "Now, little children, you are free. Go your way and I shall go mine. I shall keep the taxes and revenues just mentioned, and you—you may have the general property tax. Considering the liberality of the division, I confidently expect you to be able, in the future, to get along without the pernicious and demoralizing tax on personal property."

This thorough divorcement of state and local revenue systems is, on the surface, exceedingly attractive to almost everyone. The economist looks upon it with favor because it promises the abolition of the personal-property tax. The single taxer applauds it, because it legalizes the exemption of improvements as well as that of personal property. The business man approves it, because it offers a means of securing honorably and openly that exemption of plant and stock which so many merchants and manufacturers at the present time are securing illicitly and covertly. Of course, it may mean, instead of exemption, more strenuous attempts to assess personal property, and increasing efforts, in most localities, to lighten the load upon real estate by increasing the burden upon business. But the advocates of home rule are willing to take their chances. The programme of reform apparently promises greater liberty to everybody concerned, and, as consistent democrats, they properly refuse to be frightened by the fact that liberty may degenerate into license.

Despite its attractions, however, I believe that, on the whole, the programme just described—the idea of complete separation of state and local finances with fiscal autonomy in each sphere—is impossible of realization and retrogressive in direction, making away from and not toward the real solution of our most important problems. I believe that real progress lies in the direction of centralization, not decentralization, of fiscal control.

The reasons for this statement must be discussed in some detail.

I. In the first place, separation and home rule cannot materially increase the positive fiscal freedom of the local governments. It is doubtful whether they can safely be permitted to exempt any class of property they desire to relieve from taxation: but it is perfectly plain that they cannot be allowed to devise new taxes. Take the income tax, for example. Not only would it be impossible for a local government to administer the income tax without the right to call upon other officers of the state for information and assistance, but the difficult definitions and interpretations of income which the various local governments might introduce, would bring about an intolerable amount of multiple taxation. Or take the much more feasible project of license or business taxes upon commercial and manufacturing concerns in lieu of the present taxes upon plant and stock. The various local districts of a state could never be permitted to define and manipulate such taxes as they might see fit. Suppose a manufacturing concern had its factory and warehouse in village *A* and its principal office and salesroom in city *B*. The village might impose the present property tax on plant and stock while the city might, by adopting some plan of apportioning the total capital value of such concerns according to business done or gross income, tax practically all of this property again in another way. Furthermore, the local governments could not safely be permitted to tax individual categories of personal property as they saw fit. Take mortgage taxation. County *A* might institute a recording tax and County *B* the separate taxation of mortgages as personal property. Yet an individual mortgagee residing in *B* might lend his money in county *A*, with the result that, whether mortgagee or mortgagor ultimately paid the tax, it would be double or multiple taxation of the most vicious kind. In general, it is a safe conclusion that the income tax, business taxes, and all manner of ad-valorem assessment in the spirit of the so-called unit rule would have to be denied the local governments under the scheme of home rule. With the growing and commendable practice of distributing the intangible values of going concerns in accord-

ance with their business or tangible property, it is doubtful whether even the method of assessing tangible property can be left to the discretion of the local governments. The opportunities for double taxation are too manifold. While the habitation or occupancy tax might safely, perhaps, be left to the local governments (although even this is problematical), most of the possible substitutes for the personal-property tax can be introduced only as state taxes. As a matter of fact it is probable that the average legislature will never permit the local governments to bid against each other for the location of manufacturing concerns, although the *pros* and *cons* of this particular scheme seem to be evenly balanced. In other words, the tax laws for the local districts will always have to be made by the state legislature.

Evidently then, the phrase "home rule" does not mean exactly what the words imply. We want the local governments to have the liberty to exempt personal property, but we do not want them to have liberty to tax corporations as they please. We are advocating freedom when what we want, or at least the only thing we can have, is another kind of control. What we need is not less state regulation in the matters of local taxation, but more intelligent state regulation.

II. Not only is centralization a good thing, but we are getting more centralization every day. If we examine the forward movement which has resulted in partial or complete separation in several of our most progressive commonwealths, we find that it was aimed primarily at the reform of corporation taxation, and achieved separation incidentally, largely as a by-product. (Wisconsin, for instance, has ceased to levy property taxes for the support of the state government, but there has been no popular demand for separation in Wisconsin, practically no discussion of the subject, and little attention paid to it.) Corporation taxation under the old régime, when controlled by the local governments, had proved a striking failure; the assessment of such corporations had to be centralized, and in the process of centralization the state retained many corporation taxes simply because it was difficult to apportion corporate values, for purposes of taxation, among the various local districts. These corporation taxes proved

so lucrative in many cases, that it became practicable to discontinue the levy of state property taxes.

Now there is just one element common to this movement in practically all states. It is not the separation of state and local revenues. Many advanced states, Massachusetts for instance, are not yet within striking distance of separation. Neither is it the complete retention of corporation taxes by the state. The one characteristic of the advance movement which is always and everywhere found is centralization of the assessment power. The most striking characteristic of the past has been the decentralization of the administrative machinery of taxation. The most striking feature of the present is the universal and rapid progress toward centralization of fiscal control. And the banner of reform is being carried by the State Tax Commission.

It is unnecessary to discuss in detail the evolution of the permanent Tax Commission. At the present time permanent commissions exist in at least eight states, and scarcely a year passes without the creation of a new commission. As the number of such commissions increases, their functions are multiplied. At first they did little more than assess a few important classes of corporations. Gradually, new duties, broader powers, were added; they were instructed to provide uniform blanks for local assessments, to assist or actually to make state equalizations, to inspect and criticize the work of local assessors, to revise county equalizations, and order reassessments of property. Today, the tax commissions of seven states are empowered to institute proceedings for the removal of inefficient assessors; in seven states they are authorized to add property to the assessment rolls or to order the reassessment of particular parcels of property; in four states they may order the reassessment of entire districts; and in six states they are authorized to renew and readjust the county equalizations. It requires no unwarranted stretch of the imagination to foresee a time when the whole machinery of local and state assessment, in the more advanced American commonwealth, will be co-ordinated and correlated under the control of a high-grade permanent tax commission; when a permanent corps of expert assessors holding office during good behavior and

absolutely divorced from politics, will banish from American administration, and American politics, the miserably inefficient local assessor. It is because I see in the present programme of separation and home rule, the potential beginnings of a counter movement to this centralization of assessment, which seems to me so supremely important, that I take upon myself the unpleasant task of scrutinizing so critically the possibilities of a programme with which, in the main, I am in hearty sympathy. If home rule, local option, and fiscal decentralization militate in any important way against the reform of the local assessment work, they are not worth the cost.

III. The position just taken, the proposition that separation should be judged accordingly as it strengthens or weakens the character of the assessment work of the state, may be regarded as the central thesis of this paper, and the remainder of my time will be devoted to the consideration of a somewhat miscellaneous group of topics bearing upon this point.

First of all I desire to recall to your attention the very familiar and exceedingly important fact that, measured in dollars and cents, the work of the local assessors is far and away the most important part of our fiscal system. Compared with the general property tax, corporation taxes, inheritance taxes, and all the other taxes put together pale into insignificance. In 1902 more than three-fourths of all the general revenues of the state and local governments came from taxes upon general property, and if the state taxes levied upon general property in that year had all been secured in some other way—say by subventions from the federal government—even then, two-thirds of the aggregate general revenues of the state and local governments would have been raised by local taxes upon general property. Whether we keep or discard the taxation of personal property, the local assessor will, for many generations, continue to play the principal rôle in the work of state finance, and upon his probity and efficiency will depend the real success or failure of our fiscal system.

Now in recent years the statement has frequently been made that separation itself, carrying with it the cessation of state taxa-

tion upon general property and the abolition of the state equalization, would prove the most effective means of improving the work of the local assessors. The report of the California Commission on Revenue and Taxation is particularly enthusiastic on this point:

If there were no state tax to be apportioned among the counties, on the basis of local assessed valuation, there would be no object or inducement to the assessor or to the citizens of the county to obtain a low valuation. In fact, there would be more inducements to the assessor to assess the property as nearly as possible at its full market value in order to avoid inequalities between the citizens among his own constituents, and to protect himself against the charge of favoritism. The probability is, that in order to enjoy the advertising effect of a low tax rate the great inclination would be for the assessor to raise the valuation rather than reduce it. A high tax rate is bad advertisement for a city or a county, and if there is no state tax to be imposed upon the same valuation, the county could have the advantage of the low rate by the simple process of raising the assessed valuation from its present level of about 50 or 60 per cent. to its full value (pp. 62, 63).

With this interpretation of the probable effect of separation I find myself wholly unable to agree. The influences or factors responsible for inefficient assessment work are so numerous, that the desire to evade state taxes is really a negligible consideration. Enumerate these factors: first, the inherent difficulties of the task; next, the political atmosphere in which the assessor too often works; then, the insufficient time, insufficient pay, desire to evade county taxation, desire to favor personal friends and political associates—enumerate these factors, and it is plain, without reference to experience, that the mere discontinuance of state taxation of general property can work no appreciable improvement. If reference to experience is needed, I can only say that the practical separation accomplished in Wisconsin has not, in the opinion of those best qualified to judge, exerted any appreciable influence upon the character of the assessment work. There is the same old struggle over the county equalization, the same old strife between city and county, the same old scramble of the individual taxpayer to get from under the local assessment.

How could it be otherwise? Of the general property taxes—$706,660,244 in all—collected in this country in 1902, only

$83,320,134, or 11.6 per cent., went to the state governments, while $624,340,110, or 88.4 per cent., went to the counties, cities, and other local divisions. These figures furnish a good measure of the part which the desire to escape state taxes plays in demoralizing local assessors. The counties alone collected nearly 75 per cent. more under the general property tax than the states. If the state governments should abandon the $83,320,134 which they are now (or were in 1902) levying on general property, there would still remain $624,340,110 to be distributed and equalized among the taxpayers of the local divisions. For the state government to abandon this greater task of equalization is a cowardly evasion of its chief duty.

Another current impression, which I believe to be similarly erroneous, is the idea that, if the personal-property tax is abolished the assessment of real estate will be on the whole equitable and satisfactory. "The local taxation of real estate," says the recent Special Tax Commission of the State of New York (p. 6), "is now on the whole free from any serious objection." This may be true of New York, but it is certainly not true of most American states, and cannot become true so long as assessors are selected according to prevailing practices, and work under present conditions. During the past four years I have devoted a large part of my time to an intimate study of real-estate assessments, in a state in which the quality of the assessment work is rather above than below the average. During that time I have compared, in the case of several hundred thousand parcels of real estate, the true value as determined by actual sale with assessed value as determined by the local assessors. The deliberate conviction, forced upon me by this examination, is that the real estate assessment is, on the whole, a marked failure from the standpoint of equality. In assessment districts in which the average ratio of assessed to true value is maintained consistently at 65 or 70 per cent., individual parcels will be assessed all the way from 20 to 120 per cent. of true value. We talk glibly about the ease with which real estate can be assessed. The truth is that it is a task which challenges the highest skill of bona fide experts. Think of the speculative uncertainty of the value of

farm lands adjoining city suburbs; the baffling variety of fixed plant and machinery ordinarily assessed as real property; the problem thrust upon the county assessor by the presence in some small village of one or two manufacturing plants of whose value only an expert of long experience in that particular industry can furnish any estimate; and I think you will agree with me that the problem of assessing real estate efficiently cannot be left to the local assessors, that it demands expert treatment which only the general government, by dealing with such problems in a wholesome way, can afford to provide.

Finally, I desire to call attention to the fact that separation does not really abolish the state equalization nor prevent the distribution of the burden of state taxation among the various local divisions. What separation actually does is to substitute for a conscious distribution of state burdens in accordance with the value of property, an unconscious, unseen, and more or less haphazard distribution, which shifts the burden we know not where, and avoids the evil of faulty equalization according to property by flying to other ills we know not of. Like the ostrich in the thunderstorm, we stick our heads in the sand and stoutly maintain that it is not raining.

Consider the proposition a moment and it will cease to be merely fanciful. Ordinarily, separation can only be realized by the state's retention of the more important corporation taxes. Some of the corporations involved, or more accurately, some of the taxable corporate values involved, like trust companies in New York, might with equal propriety, in whole or in part, be assigned to the local governments for taxation; and when they are not so assigned, such local divisions bear *pro tanto* the burden of supporting the state. And other things being equal, assignment to the local divisions should be the rule and not the exception. Unless there is no natural relation between property or business and the expenses of government, there is a *prima facie* presumption in favor of local taxation; and this initial presumption is indefinitely strengthened by the enormous fiscal burdens under which our municipalities are now staggering. For it is probably true—although I speak with hesitancy on this point—

that separation as it is ordinarily achieved considerably increases the burden of the city governments, in the sense that the cities would probably receive the major portions of such corporate values if they were localized according to the best principles of apportionment.

Many persons will commend separation for this very reason, on the ground that the enormous escape of personality in the cities makes the latter fit recipients of increased state taxation. But I believe this contention is unsound. It loses sight of the stupendous social tasks thrust upon our cities by the mere growth of population. City government, to a large extent, is characterized by what the economists call the law of increasing costs. And it loses sight of the still more important fact, that shifting a larger load of state taxes upon the city communities is not going to get the extra load on the shoulders of the men who evade the personal-property tax. In short it fails to improve the distribution of taxes between man and man in the city.

Moreover, it is not only corporation taxes which the state governments have monopolized. The largest source of state revenue in New York is the liquor license; there would be no difficulty in assigning that revenue to the appropriate local divisions. The second most productive source of state revenue in Pennsylvania is the tax or group of taxes on personal property. Are its burdens distributed among the local districts, and if so, is the distribution more or less equitable than that which would be accomplished by a conscious state equalization? In order to separate the sources of state and local revenue in California, the Commission on Revenue and Taxation of that state proposes that the central government shall retain, in addition to the poll, inheritance, and insurance premium taxes, all taxes upon steam and street railways; express companies; car companies; light, heat, and power companies; telegraph and telephone companies; the corporate excess of banks and all corporate franchises not covered by the above taxes. Unless the presence of property at a place has no connection with the public expenditures of that place, unless the right to exploit the commercial opportunities of that place creates no obligation to pay taxes at that place, unless the Adams Express case is moonshine and the principle of the

Ford Franchise law a delusion, then street-car companies, heating and lighting plants, most banks, and some telephone companies owe most of their fiscal allegiance to fairly well-defined local districts; and when these local districts are deprived by the state of the power of taxing such corporations, they are saddled with burdens of state taxation which belong elsewhere.[3] The unseen equalization involved in separation is a very real phenomenon. Certain it is that no state legislature should decide to separate the sources of state and local revenues without clearly understanding that under any scheme the expenses of the state government must be distributed in some way among the various local divisions, nor without satisfying itself that the new distribution of state burdens proposed, will be more equitable than the old.

IV. The practical conclusions which I would derive from the preceding discussion may be formulated in the following statements:

1) The state legislature should, in my opinion, without reference to the local divisions and without respect for impossible plans of local fiscal democracy, abolish the personal-property tax and introduce a substitute therefor, if one can be devised.

2) If this is impracticable, they should introduce at once some scheme of limited local option which will permit particular districts to abolish that fiscal abomination, the personal-property tax. No plan should be entertained, however, which will interfere with central suspension of assessments and central control over county equalizations.

3. This carefully limited measure of local option should be introduced without reference to the separation of state and local revenues.

4) Similarly, the question of what sources of revenue should be retained by the state, ought to be settled absolutely on its merits without reference to home rule, by a careful study of tax jurisdictions and the connection between property or business and the expenses of local government. Doubtful points should be

[3] The California plan is cited merely for illustrative purposes, and not with the idea of criticizing the California Commission. Under ordinary circumstances, such a division of revenues seems manifestly unjust.

decided in favor of the local jurisdictions; and equitable apportionment should not be strained one inch in order merely to supply the state with revenue enough to get along without the levy of direct property taxes. If, after the apportionment of sources between state and local governments, the state has not sufficient special revenue to pay its expenses, let the deficit be raised by a state tax upon real estate, including in real estate the corporate and commercial values assigned to the local governments. The evils of an equalization based upon real estate are less than the evils of the unconscious, haphazard equalization involved in the retention by the state of a number of revenues which more logically belong to the local divisions.

5) Finally, I assert with some confidence, that if the equalization is confined to real estate, and if it is made by an efficient tax commission which takes its work seriously, it is not a curse but a blessing. In the first place, the payment of some direct state tax stimulates the interest of the citizen in the expenditures of the state government. In the second place, the equalization can be made, with all necessary accuracy, so accurately in fact that no fair-minded person, after studying thoroughly the conditions of the problem, will question its substantial accuracy as between county and county. It can be made without prohibitive expense—it is not necessary, as is sometimes asserted, to reassess every parcel of real estate in the commonwealth to get at the truth. And in gathering the data upon which to base its conclusions, the tax commission will obtain indispensable information concerning local assessment work, besides securing material absolutely necessary for the proper performance of the work of county equalization. The county equalizations are, in the aggregate, more important than the state equalization; but at the present time they are woefully inaccurate. The county officials who make these equalizations are, as a rule, destitute of reliable data upon which to base their apportionments, and, like the local assessors, they will never do their work efficiently until they are forced to do so by central supervision and state aid. Reform in these matters must come from without.

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